

Message Text

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ACTION SS-25

INFO OCT-01 ADP-00 /026 W

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R 051515Z JUL 73

FM AMEMBASSY BONN

TO SECSTATE WASHDC 6119

INFO AMEMBASSY HELSINKI

S E C R E T SECTION 01 OF 02 BONN 09594

EXDIS

HELSINKI FOR THE SECRETARY

PASS TREASURY AND FEDERAL RESERVE

E.O. LL652: GDS

TAGS: PFOR; EFIN; GW

SUBJECT: CONVERSATION WITH FINANCE MINISTER SCHMIDT

1. SUMMARY: IN A FRANK DISCUSSION WITH ME ON JULY 3, FRG FINANCE MINISTER HELMUT SCHMIDT PRESENTED A SOMEWHAT PESSIMISTIC ANALYSIS OF THE PRESENT SITUATION ON THE EUROPEAN MONETARY EXCHANGES. THE PRIMARY FACTOR, IN HIS VIEW, MAKING FOR THE RECENT DECLINE OF THE DOLLAR HAS BEEN A RUN-AWAY PSYCHOLOGICAL LOSS OF CONFIDENCE BROUGHT ABOUT BY SEVERAL DEVELOPMENTS INCLUDING THE CONTINUING US PAYMENTS DEFICIT AND THE FEELING IN EUROPE THAT CURRENT US POLICIES WILL NOT BE ADEQUATE TO CONTROL INFLATIONARY PRESSURES. HE WAS REASONABLY HOPEFUL, HOWEVER, THAT THE RECENT GERMAN REVALUATION OF 5.5 PERCENT WOULD BRING ON A TEMPORARY PERIOD OF STABILITY IN TERMS OF THE MARK RELATIONSHIP TO OTHER EUROPEAN CURRENCIES WITHIN THE SNAKE. END SUMMARY

2. I CALLED ON FINANCE MINISTER HELMUT SCHMIDT ON JULY 3 TO DISCUSS THE CURRENT MONETARY SITUATION. HE BEGAN BY SAYING THAT HIS GOVERNMENT FELT THERE HAD BEEN NO ALTERNATIVE TO THE MOST RECENT 5.5. PERCENT REVALUA-

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TION OF THE D-MARK IF THE SNAKE WERE TO BE PRESERVED,

ALTHOUGH PRESSURES FROM GERMAN INDUSTRY AGAINST SUCH ACTION WERE HEAVY. THE CURRENT SITUATION OF THE DOLLAR ON THE EXCHANGES WAS A DEPLORABLE ONE, TO BE EXPLAINED ONLY IN TERMS OF A RUN-AWAY PSYCHOLOGICAL LOSS OF CONFIDENCE. IT OBVIOUSLY DID NOT INVOLVE REAL VALUES, BUT THERE SEEMED TO BE A LACK OF CONFIDENCE IN US ABILITY TO CONTROL INFLATIONARY PRESSURES, REINFORCED BY THE CONTINUING US PAYMENTS DEFICIT.

3. HE AND SOME OF HIS ADVISERS HAD ASSUMED, SCHMIDT CONTINUED, THAT FURTHER REVALUATION OF THE MARK WOULD ALSO HAVE A DEPRESSIVE EFFECT ON THE DOLLAR, EVEN THOUGH IT DID NOT HAVE A DIRECT IMPACT ON THE DOLLAR-MARK CENTRAL RATE. THIS WAS NOT, HOWEVER, THE UNANIMOUS EXPECTATION WITHIN THE GERMAN BANKING COMMUNITY AND, AS A MATTER OF FACT, BUNDESBANK PRESIDENT KLASSEN HAD ARGUED THAT THERE WOULD BE A RISE IN THE VALUE OF THE DOLLAR FOLLOWING THE GERMAN ACTION. HE HAD OBVIOUSLY BEEN PROVED WRONG.

4. SCHMIDT SAID THAT HE WAS REASONABLY OPTIMISTIC THAT HEAVY PRESSURES WOULD NOW SUBSIDE ON THE CURRENCIES WITHIN THE SNAKE, ALTHOUGH HE ALLOWED FOR THE POSSIBILITY OF SOME MOVEMENT UPWARD OF THE D-MARK. ONE STABILIZING FACTOR WOULD BE THE SEASONAL OUTPOURING OF GERMAN TOURISTS ALL OVER EUROPE EXCHANGING LARGE AMOUNTS OF MARKS FOR LOCAL CURRENCIES.

5. AS FAR AS THE DOLLAR WAS CONCERNED, SCHMIDT EMPHASIZED, HE WOULD NOT PARTICULARLY WELCOME US INTERVENTION IN ITS SUPPORT AT THE PRESENT TIME IF ALL THAT MEANT WAS THE USE OF DM'S OBTAINED UNDER A SWAP ARRANGEMENT. THIS WOULD MERELY ADD TO THE INFLATIONARY PRESSURES, SCHMIDT CONTINUED, WITHIN THE FRG AT A TIME WHEN, HE BELIEVED, THE GOVERNMENT'S ANTI-INFLATION MEASURES WERE JUST BEGINNING TO TAKE HOLD. ONE THING THE US COULD USEFULLY DO, HOWEVER, WAS TO SELL SOME OF ITS GOLD. IF WE WERE WILLING, FOR EXAMPLE, TO DISPOSE OF SOME 300 MILLION WORTH OF GOLD, THE FRG AND PERHAPS SOME OTHER EUROPEAN COUNTRIES WOULD BE PREPARED TO JOIN IN WITH ADDITIONAL GOLD SALES. HIS

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EXPERTS BELIEVED THAT, IN VIEW OF THE NARROWNESS OF THE GOLD MARKET, SUCH SALES WOULD SIGNIFICANTLY REDUCE THE PRESENT INFLATED PRICE OF GOLD. THE EFFECT OF ANY SUCH REDUCTION WOULD BE PSYCHOLOGICALLY IMPORTANT IN REDUCING PRESSURES ON THE DOLLAR, SINCE THE PRESENT PRICE OF GOLD (THREE TIMES THAT OF THE OFFICIAL GOLD VALUE OF THE DOLLAR) SIGNALLED TO THE ENTIRE WORLD THE WEAKNESS OF THE DOLLAR.

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6. IN VIEW OF THE WIDESPREAD LOSS OF CONFIDENCE IN THE DOLLAR, SCHMIDT SAID HE COULD NOT BE OTHER THAN GLOOMY ABOUT THE POSSIBILITY THAT THE DOLLAR MIGHT DECLINE EVEN FURTHER IN VALUE. ONE THING CLEAR WAS THAT HE WOULD NOT PERSONALLY BE IDENTIFIED WITH ANY FURTHER FORMAL REVALUATION OF THE GERMAN MARK. HE BELIEVED ITS OVER-VALUATION WAS ALREADY SO GREAT THAT, WITH THE CHANGE IN THE BUSINESS CYCLE HE ANTICIPATED NEXT YEAR, GERMAN EXPORT INDUSTRIES WOULD BE HARD HIT AS DEMAND DECLINED AND IT BECAME OBVIOUS THAT THEIR PRODUCTS HAD BECOME OVER-PRICED IN A CONTRACTING MARKET. IT WAS THE FIRST TIME HE HAD SAID THIS, BUT IF NECESSARY THE FRG WOULD ABANDON THE SNAKE AND LET THE DM FLOAT ALONE RATHER THAN REVALUE AGAIN IN ANY FORM. THIS WOULD BE BOTH A POLITICAL AND AN ECONOMIC NECESSITY FOR THE GERMAN GOVERNMENT, DESPITE THE NEGATIVE EFFECT IT WOULD HAVE ON THE MOVEMENT TOWARDS EUROPEAN MONETARY UNION. LIKEWISE, THE NEED TO COMBAT INFLATION IN THE FRG WOULD MAKE IMPOSSIBLE ANY FURTHER SUPPORT OF THE DOLLAR BY BUNDESBANK ACTION ON THE EXCHANGES SUCH AS HAD OCCURRED IN THE PAST.

7. DURING OUR CONVERSATION I MADE THE OBVIOUS ARGUMENTS, STRESSING THAT THE KIND OF PESSIMISM WHICH HE HAD EXPRESSED ABOUT US EFFORTS TO COMBAT INFLATION WERE NOT WARRANTED BY THE FACTS, THAT PRICE MOVEMENTS IN THE US

WOULD BE FAVORABLE, AND THAT, WHILE CERTAIN PRICE AND
DEMAND INELASTICITIES HAVE PERHAPS PROVED MORE STUBBORN

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THAN ANTICIPATED, A TURN-AROUND IN THE TRADE
BALANCE WAS ALREADY NOTICEABLE. IT WAS INCONCEIVABLE, I
ARGUED, THAT SUCH A DRASTIC CHANGE IN MONETARY PARITIES
AS HAD OCCURRED IN RECENT YEARS WOULD NOT IN THE LONG
RUN HAVE THE EFFECT ON IMPORTS AND EXPORTS WHICH
CLASSICAL INTERNATIONAL TRADE AND MONETARY THEORY PRES-
CRIBED. ALTHOUGH HE ACKNOWLEDGED SOME OF THESE POINTS
MIGHT BE VALID, HE WAS NOT PREPARED TO DEVIATE FROM THE
BASIC APPRAISAL WHICH HE HAD MADE.

8. COMMENT: SCHMIDT IS JUST ABOUT TO DEPART ON A
FIVE-WEEK VACATION WHICH HE HOPES WILL NOT THIS YEAR BE
INTERRUPTED BY A MONETARY CRISIS AS WAS THE CASE IN
L972. HE WAS IN ONE OF HIS MORE DIDACTIC MOODS, BUT
HIS ANALYSIS WAS BASICALLY SOMBER, BOTH AS TO THE
LONG-RANGE IMPLICATIONS OF WHAT HE CONSIDERS TO BE OVER-
VALUATION OF THE DM AND THE PROSPECTS FOR THE DOLLAR.
HE APPARENTLY HAS LOST THE INCLINATION WHICH HE DIS-
PLAYED DURING HIS EARLIER MONTHS AS FINANCE MINISTER TO
RELY ON EXCHANGE CONTROLS IN EXTREMIS, SINCE THE
EXPERIENCE OF HIS GOVERNMENT WITH CONTROLS DURING THE
PAST YEAR WAS SINGULARLY UNSUCCESSFUL IN RESTRICTING
THE FLOW OF DOLLARS INTO GERMANY.
HILLENBRAND

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